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BEFORE THE ARIZONA CORPORATION (RECEIVED

COMMISSIONERS

2010 MAY 18 A 9:49

KRISTIN K. MAYES, Chairman
GARY PIERCE
PAUL NEWMAN
SANDRA D. KENNEDY
BOB STUMP

AZ CORP COMMISSION
DOCKET CONTROL

IN THE MATTER OF THE APPLICATION OF)
ARIZONA-AMERICAN WATER COMPANY, AN)
ARIZONA CORPORATION, FOR A)
DETERMINATION OF THE CURRENT FAIR)
VALUE OF ITS UTILITY PLANT AND)
PROPERTY AND FOR INCREASES IN ITS)
RATES AND CHARGES BASED THEREON FOR)
UTILITY SERVICE BY ITS ANTHEM WATER)
DISTRICT AND ITS SUN CITY WATER)
DISTRICT.)

DOCKET NO. W-01303A-09-0343

Arizona Corporation Commission

DOCKETED

MAY 18 2010

DOCKETED BY

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IN THE MATTER OF THE APPLICATION OF)
ARIZONA-AMERICAN WATER COMPANY, AN)
ARIZONA CORPORATION, FOR A)
DETERMINATION OF THE CURRENT FAIR)
VALUE OF ITS UTILITY PLANT AND)
PROPERTY AND FOR INCREASES IN ITS)
RATES AND CHARGES BASED THEREON FOR)
UTILITY SERVICE BY ITS ANTHEM/AGUA)
FRIA WASTEWATER DISTRICT, ITS SUN CITY)
WASTEWATER DISTRICT AND ITS SUN CITY)
WEST WASTEWATER DISTRICT)

DOCKET NO. SW-01303A-09-0343

ANTHEM COMMUNITY
COUNCIL'S NOTICE OF FILING
OF DIRECT TESTIMONY OF
MICHAEL L. ARNDT

By means of this submittal, the Anthem Community Council hereby provides notice of its
filing of Direct Testimony of Michael L. Arndt.

Dated this 17th day of May 2010.

Respectfully submitted,

Judith M. Dworkin
Sacks Tierney PA

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and

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Tubac, Arizona 85646-1448

By: Lawrence V. Robertson, Jr.
Lawrence V. Robertson, Jr.
Attorneys for Anthem Community Council

The original and thirteen (13) copies of the
foregoing Notice are being emailed/mailed
this 17th day of May 2010 to:

Docket Control
Arizona Corporation Commission
1200 West Washington Street
Phoenix, Arizona 85007

A copy of the foregoing Notice is being
mailed or emailed this same date to:

Teena Wolfe, Administrative Law Judge
Hearing Division
Arizona Corporation Commission
1200 West Washington
Phoenix, Arizona 85007

All parties of record

ATC

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BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

KRISTIN K. MAYES, Chairman
GARY PIERCE
PAUL NEWMAN
SANDRA D. KENNEDY
BOB STUMP

IN THE MATTER OF THE APPLICATION OF)
ARIZONA AMERICAN WATER COMPANY,) DOCKET NO. W-01303A-09-0343
AN ARIZONA CORPORATION, FOR A)
DETERMINATION OF THE CURRENT FAIR)
VALUE OF ITS UTILITY PLANT AND)
PROPERTY AND FOR INCREASES IN ITS)
RATES AND CHARGES BASED THEREON)
FOR UTILITY SERVICE BY ITS ANTHEM)
WATER DISTRICT AND ITS SUN CITY)
WATER DISTRICT)
-----)

IN THE MATTER OF THE APPLICATION)
OF ARIZONA AMERICAN WATER) DOCKET NO. WS-01303A-09-0343
COMPANY, AN ARIZONA CORPORATION,)
FOR A DETERMINATION OF THE)
CURRENT FAIR VALUE OF ITS UTILITY)
PLANT AND PROPERTY AND FOR)
INCREASES IN ITS RATES AND CHARGES)
BASED THEREON FOR UTILITY SERVICE)
BY ITS ANTHEM/AGUA FRIA)
WASTEWATER DISTRICT, ITS SUN CITY)
WASTEWATER DISTRICT AND ITS SUN)
CITY WEST WASTEWATER DISTRICT)
-----)

DIRECT TESTIMONY OF
MICHAEL L. ARNDT

ON BEHALF OF
THE ANTHEM COMMUNITY COUNCIL

May 17, 2010

1 **Q.1 PLEASE STATE YOUR NAME, OCCUPATION AND ADDRESS.**

2 A.1 My name is Michael L. Arndt. I am a public utility rate consultant and my address is
3 3602 S.W. Zona Circle, Ankeny, Iowa 50023.
4

5
6 **Q.2 HAVE YOU PROVIDED AN ATTACHMENT WHICH DETAILS YOUR**
7 **EDUCATIONAL BACKGROUND AND PROFESSIONAL EXPERIENCE?**

8 A.2 Yes. Attached Appendix A is a statement of my education and experience.
9

10 **Q.3 HAVE YOU TESTIFIED BEFORE THIS COMMISSION PREVIOUSLY?**

11 A.3 Yes. In addition to the Arizona Corporation Commission ("ACC" or "Commission"),
12 I have presented testimony before the Federal Energy Regulatory Commission and state
13 regulatory commissions in Alabama, Arkansas, Colorado, Iowa, Maryland, Nebraska,
14 Oklahoma, Pennsylvania, Rhode Island, Texas, Utah, Vermont and West Virginia. In
15 addition, I have worked on cases in several other states, the District of Columbia and
16 Barbados. I have testified in more than 100 public utility rate proceedings.
17
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20 **Q.4 ON WHOSE BEHALF ARE YOU APPEARING IN THIS PROCEEDING?**

21 A.4 I am appearing on behalf of the Anthem Community Council ("Anthem"). Anthem has
22 intervened in this proceeding on behalf of over 8,800 of its residents that are water and
23 wastewater customers of Arizona American Water Company ("AAWC" or
24 "Company").
25
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1 **Q.5 WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS CASE?**

2 A.5 The purpose of my testimony is to address the concerns expressed by Company witness
3 James M. Jenkins regarding Anthem witness Mr. Dan L. Neidlinger's ratable plant
4 transfer proposal.
5

6
7 **Q.6 PLEASE DESCRIBE THE COMPANY.**

8 A.6 The Company is a wholly-owned subsidiary of American Water Corporation ("AWC").
9 AWC is headquartered in Voorhees, New Jersey, and is the largest investor-owned
10 water and wastewater utility company in the United States. AWC is the parent
11 company for nineteen state subsidiaries (i.e., including Arizona-American Water
12 Company).¹ AWC serves approximately 16,000,000 people in approximately 1,600
13 communities in the United States and Manitoba and Ontario, Canada. In 2009,
14 American Water Corporation reported total revenues of \$2,445,000,000 and total net
15 plant of \$10,500,000,000.²
16
17
18

19 **Q.7 HAVE YOU REVIEWED THE PRE-FILED DIRECT TESTIMONY OF**
20 **ANTHEM WITNESS DAN L. NEIDLINGER FILED ON MARCH 8, 2010 AND**
21 **ON MAY 3, 2010?**

22 A.7 Yes.
23
24

25 ¹ American Water Corporation's wholly-owned regulated water and wastewater subsidiaries include Arizona
26 American Water, California American Water, Hawaii American Water, Illinois American Water, Indiana American
27 Water, Iowa American Water, Kentucky American Water, Long Island American Water, Maryland American
28 Water, Michigan American Water, New Jersey American Water, New Mexico American Water, Ohio American
Water, Pennsylvania American Water, Tennessee American Water, Texas American Water, Virginia American
Water and West Virginia American Water. Tennessee American Water provides water service to part of northern
Georgia.

² American Water Corporation website and Value Line, January 22, 2010, page 1793.

**Q.8 PLEASE SUMMARIZE YOUR UNDERSTANDING OF MR. NEIDLINGER'S
PHASE-IN PROPOSAL.**

A.8 Mr. Neidlinger's testimony addresses the "rate shock" issue related to the requested water and wastewater increases for the Company's Anthem District. The Company has proposed major increases in its water and wastewater rates based on a calendar 2008 test year. For the Anthem District, the Company's requests will result in substantial increases in average residential water and average residential wastewater bills.

The Company's proposed rate increases in this case are due in large part to the refunding of \$20.2 million of Advances In Aid of Construction ("AIAC") to Pulte Homes in March 2008.³

Anthem witness Neidlinger proposes to mitigate the rate shock of the Company's proposed increases by deferring the ratemaking recognition of the water and wastewater net plant associated with the 2008 Pulte refund of \$20.2 million. Mr. Neidlinger proposes that the "deferred" amounts be transferred into plant in service ratably over the five year period of 2009 through 2013. In addition, Mr. Neidlinger suggests the same treatment would be appropriate for a \$6.7 million payment made to Pulte in March 2010, with a ratable plant transfer over the years 2011 through 2015, but that amount is outside the test period in this case.

**Q.9 HAVE YOU REVIEWED THE PRE-FILED TESTIMONY OF COMPANY
WITNESS JAMES M. JENKINS FILED ON MAY 7, 2010?**

A.9 Yes.

³ The \$20.2 million ACAC refund to Pulte Homes in March 2008 relates to \$14.9 million of water utility plant and \$5.3 million to wastewater utility plant. Mr. Neidlinger's Direct Testimony, page 5, lines 9-11.

Q.10 PLEASE SUMMARIZE YOUR UNDERSTANDING OF MR. JENKINS' TESTIMONY.

A.10 Mr. Jenkins opposes Anthem witness Neidlinger's proposal to ratably defer ratemaking recognition of the water and wastewater net plant associated with the 2008 Pulte refund. Mr. Jenkins argues that Anthem's proposed ratable plant transfer plan would require the Company to report a loss for financial reporting purposes.

Q.11 WHAT IS THE BASIS FOR MR. JENKINS' OPPOSITION TO ANTHEM'S PHASE-IN PLAN?

A.11 Mr. Jenkins argues that Anthem's ratable plant transfer plan does not comply with the Financial Accounting Standards Board's ("FASB") Statement of Financial Accounting Standards ("SFAS") No. 92, Regulated Enterprises—Accounting for Phase-In Plans.⁴

Q.12 BEFORE ADDRESSING SFAS 92, PLEASE DESCRIBE THE FINANCIAL ACCOUNTING STANDARDS BOARD.

A.12 The Financial Accounting Standards Board is a private, not-for-profit organization whose primary purpose is to develop generally accepted accounting principles ("GAAP") within the United States. FASB was created in 1973 and replaced the Committee on Accounting Procedure ("CAP") and the Accounting Principles Board ("APB").

⁴ SFAS 92 is currently referred to as Accounting Standards Codification ("ASC") 980-340. The Accounting Standards Codification became effective for interim and annual periods ending after September 15, 2009.

1 Q.13 DO YOU AGREE THAT FASB'S SFAS 92 PRECLUDES COMMISSION
2 ADOPTION OF ANTHEM'S PROPOSED RATABLE PLANT TRANSFER PLAN
3 IN THIS RATE CASE?

4 A.13 No. FASB's SFAS 92 was issued in August 1987 and relates to phase-in plans
5 concerning plant completed before January 1, 1988 and plants on which substantial
6 physical construction had been performed before January 1, 1988. In addition, SFAS
7 92 does not address refunds relating to prior AIACs. SFAS 92, therefore, does not
8 apply in this case.
9

10
11 Q.14 WHAT WAS THE PURPOSE OF SFAS 92 WHEN IT WAS ISSUED IN AUGUST
12 1987?

13
14 A.14 SFAS 92 was issued in August 1987 to address the high costs of electric utility power
15 plants which were being placed in service at that time. SFAS 92 states the following:

16
17 The cost of electric utilities' plants constructed in recent years
18 has been much greater than the cost of those completed in earlier
19 years, so that, for some utilities, conventional rate-making
20 methods would result in significantly increased rates when a
21 newly completed plant goes into service. In such cases, some
22 regulators have adopted phase-in plans to moderate the initial rate
23 increase. The objective of those plans is to increase rates more
24 gradually than would be the case under conventional rate making,
25 while providing the utility eventual recovery of all of its
26 allowable costs and a return on investment.

27
28 FASB Statement No. 71, Accounting for the Effects of Certain
Types of Regulation, was issued in December 1982. Shortly
after the Statement was issued, major events in the electric utility
industry caused the Board to review the effects of the Statement
on the accounting for those events. After that review, the Board
decided to amend Statement 71 to provide more specific guidance
on the accounting for some of those events and to change the
accounting for others. (Emphasis added)

1 **Q.15 ARE YOU AWARE OF ANY PRIOR WATER OR WASTEWATER RATE**
2 **CASES IN THE UNITED STATES WHICH SFAS 92 HAS BEEN USED AS A**
3 **REASON TO REJECT OR NOT ADOPT A RATABLE PLANT TRANSFER**
4 **PLAN, SUCH AS PROPOSED BY ANTHEM WITNESS NEIDLINGER?**

5 **A.15** No. To my knowledge there have been no such cases or utility commission decisions
6 of that nature.
7

8
9 **Q.16 MR. JENKINS ARGUES THAT IF ANTHEM'S PLAN IS ADOPTED, THE**
10 **COMPANY WOULD HAVE TO REPORT A LOSS FOR FINANCIAL**
11 **REPORTING PURPOSES. WHAT IS THE INDICATED BASIS FOR MR.**
12 **JENKINS ARGUMENT IN THAT REGARD?**

13 **A.16** Mr. Jenkins argues that SFAS 90, Regulated Enterprises—Accounting for
14 Abandonments and Disallowances of Plant Costs, provides guidance on cost
15 disallowances.⁵ Mr. Jenkins states, "When it becomes probable that part of the cost of
16 a recently completed plant will be disallowed for rate-making purposes and a reasonable
17 estimate of the amount of the disallowance can be made, the estimated amount of the
18 probable disallowance shall be deducted from the reported cost of the plant and
19 recognized as a loss."⁶ (Emphasis added)
20
21
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23

24 **Q.17 WHEN WAS SFAS 90 ISSUED?**

25 **A.17** SFAS 90 was issued in December 1986.
26
27

28 ⁵ SFAS 90 is currently referred to as Accounting Standards Codification 980-360.

⁶ Company witness James M. Jenkins, Rebuttal Testimony, page 5, lines 7-10.

1 Q.18 WHAT WAS THE PURPOSE OF SFAS 90 WHEN IT WAS ISSUED IN
2 DECEMBER 1986?

3 A.18 SFAS 90 was issued in December 1986 to address the abandonments of plants and
4 disallowances of costs of electric utility plants. SFAS 90 states the following:

5 This Statement amends FASB Statement No. 71, Accounting for
6 the Effects of Certain Types of Regulation, for two types of
7 events that recently have occurred in the electric utility
8 industry—abandonments of plants and disallowances of costs of
recently completed plants.

9 FASB Statement No. 71, Accounting for the Effects of Certain
10 Types of Regulation, was issued in December 1982. Shortly
11 after that Statement was issued, major events in the electric
12 utility industry caused the Board to review the effects of the
13 Statement on the accounting for those events. After considering
14 the application of the Statement, the Board decided to amend
Statement 71 to provide more specific guidance for some of those
events and to change the accounting for others. (Emphasis
added)

15
16 Q.19 ARE YOU AWARE OF ANY PRIOR WATER OR WASTEWATER RATE
17 CASES OR UTILITY COMMISSION DECISIONS IN THE UNITED STATES IN
18 WHICH SFAS 90 HAS BEEN USED TO (1) REJECT A RATABLE PLANT
19 TRANSFER PLAN, SUCH AS PROPOSED BY ANTHEM WITNESS
20 NEIDLINGER; OR (2) TO REQUIRE A WATER OR WASTEWATER UTILITY
21 TO REPORT A LOSS FOR FINANCIAL REPORTING PURPOSES IN
22 CONNECTION WITH SUCH A PLAN?

23
24 A.19 No. There is no such cases or decisions to my knowledge.
25

26 Q.20 DOES FASB'S SFAS 90 PROHIBIT COMMISSION ADOPTION OF ANTHEM'S
27 RATABLE PLANT TRANSFER PLAN IN THIS RATE CASE?
28

1 A.20 No. FASB's SFAS 90 was issued in December 1986 to address the abandonments of
2 plants and disallowances of costs of electric utility plants. In that regard, SFAS 90
3 does not address refunds relating to prior AIACs.

4 In addition, the Water Company has not abandoned any water or wastewater
5 plant in this case; and Anthem's ratable plant transfer proposal does not contemplate or
6 require a disallowance of utility plant. SFAS 90, therefore, does not apply in this case.
7
8

9 **Q.21 ASSUMING THE COMMISSION ADOPTS ANTHEM'S PROPOSED PLAN AND**
10 **THE COMPANY'S PARENT ELECTS FOR WHATEVER REASON TO**
11 **REPORT SUCH ADOPTION AS SOME "LOSS" FOR FINANCIAL**
12 **REPORTING PURPOSES, PLEASE COMMENT UPON HOW THAT WOULD**
13 **BE REFLECTED IN THE FINANCIAL STATEMENTS OF THE COMPANY'S**
14 **PARENT.**
15

16 A.21 As noted previously, the Company is a wholly-owned subsidiary of American Water
17 Corporation. AWC is the largest investor-owned water and wastewater utility company
18 in the United States. In 2009, AWC reported total revenues of \$2.445 billion and total
19 net plant of \$10.500 billion.
20

21 If AWC elected to report some type of "loss" for financial reporting purposes in
22 its consolidated financial statements related to a Commission adoption of Anthem's
23 ratable plant transfer plan in the Company's current case, AWC would fully disclose
24 the "loss" for financial reporting purposes in its notes to its consolidated financial
25 statements. Such a disclosure would explain that the Commission had approved or
26 adopted the plan in order to mitigate rate shock which would otherwise occur. The
27
28

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1 notes would (1) explain the contemplated deferred ratemaking recognition of certain
2 water and wastewater net plant costs associated with the 2008 Pulte refund; and (2)
3 inform investors that these costs would be recovered in future rate cases involving the
4 Company. If properly reported, the notes would not suggest that the Commission had
5 "disallowed" the 2008 \$20.2 million refund payment to Pulte Homes, nor would the
6 plant be characterized as "abandoned."
7

8
9 **Q.22 DO YOU HAVE ANY ADDITIONAL COMMENTS CONCERNING ANTHEM'S**
10 **PROPOSAL TO DEFER THE RATEMAKING RECOGNITION OF CERTAIN**
11 **WATER AND WASTEWATER NET PLANT COSTS ASSOCIATED WITH THE**
12 **2008 PULTE REFUND?**
13

14 **A.22** Yes. The Company's \$20.2 million in AIAC payments to Pulte Homes during the 2008
15 test year in this case represents an abnormal and extraordinary event which needs to be
16 addressed for ratemaking purposes. The Company has requested very substantial
17 increases in water rates and wastewater rates based on a calendar 2008 test year.
18 These increases are particularly large for the Anthem water and wastewater ratepayers.
19 Against that background, Mr. Neidlinger developed the proposed ratable plant transfer
20 plan to mitigate that rate shock which Anthem customers will experience.
21

22 In that regard, I also believe that rate shock should be a primary concern for the
23 Commission in this case, particularly given the current economic conditions. Anthem's
24 plan properly addresses and mitigates the problem of rate shock.
25
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1 Q.23 DOES THIS COMPLETE YOUR TESTIMONY AT THIS TIME?

2 A.23 Yes, it does.

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STATEMENT OF EDUCATION AND EXPERIENCE

MICHAEL L. ARNDT

**Arndt & Associates
3602 S.W. Zona Circle
Ankeny, Iowa 50023
(515) 964-8902**

Mr. Arndt received a Bachelor of Arts degree in Business Administration from Northwestern College in 1974 and a Master of Business Administration degree from Drake University in 1978. He has also taken additional graduate level courses in accounting, auditing, economics, finance and taxation at the University of Maryland. Mr. Arndt is a Certified Public Accountant in Maryland.

Mr. Arndt has attended numerous seminars and training courses related to public utility regulation, income taxes and other issues, including the National Association of Regulatory Utility Commissioners ("NARUC") Annual Regulatory Studies Program at Michigan State University.

Following graduation in 1974, Mr. Arndt was employed by the Utilities Division of the Iowa State Commerce Commission in Des Moines, Iowa. His responsibilities with the Iowa Commission included analyses of cost of service issues and testifying in rate proceedings of electric, gas, telephone and water utilities.

In 1979, Mr. Arndt joined Hess & Lim, Inc., a public utility consulting firm located in the Washington, D.C. area providing consulting services to a variety of clients including state regulatory commissions, consumer advocate agencies, municipalities and corporations. His responsibilities included performing analyses of utility ratemaking issues and testifying in proceedings before federal and state regulatory commissions on behalf of the firm's clients.

In December 1990, Mr. Arndt formed the public utility consulting firm of Arndt & Associates and has continued performing analyses of utility rate filings and testifying in proceedings on behalf of various clients.

Mr. Arndt has testified in more than 100 public utility rate proceedings before the Federal Energy Regulatory Commission and the state regulatory commissions of Alabama, Arizona, Arkansas, Colorado, Iowa, Maryland, Nebraska, Oklahoma, Pennsylvania, Rhode Island, Texas, Utah, Vermont and West Virginia. In addition, Mr. Arndt has worked on cases in several other states, the District of Columbia and Barbados. His testimony in prior proceedings has involved issues related to the determination of revenue requirements, income taxes, affiliated transactions, depreciation, securitization, excess cost over market ("ECOM"), unbundling, allocations and rate design.

In addition to public utility rate cases, Mr. Arndt has participated in various court proceedings on behalf of clients involving antitrust, Modified Final Judgment ("MFJ") violations, breach of contract, utility property damage and telephone directory cases.